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ZNR UUUUU ZZH
R 141540Z MAR 08
FM AMEMBASSY OTTAWA
TO RUEHC/SECSTATE WASHDC 7521
INFO RUCNCAN/ALL CANADIAN POSTS COLLECTIVE
RUEHME/AMEMBASSY MEXICO 1801
RUEHFR/AMEMBASSY PARIS 0991
RUCPDOG/USDOC WASHDC

UNCLAS SECTION 01 OF 04 OTTAWA 000378

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STATE FOR WHA/CAN and EEB/IFD/OIA and EEB/DCT

STATE PASS USTR FOR MELLE AND SULLIVAN

USDOC FOR 4320/OFFICE OF NAFTA/GWORD/TFOX;
3134/OIO/WESTERN HEMISPHERE

PARIS FOR USOECD

E.O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [EIND](#) [EINV](#) [PREL](#) [CA](#)

SUBJ: CANADIAN PERSPECTIVES ON NAFTA: KEEP, KILL OR FIX?

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SUMMARY/INTRODUCTION

¶1. (U) The current debate over the North American Free Trade Agreement (NAFTA) in the U.S. Presidential primaries has sparked widespread commentary in Canada. This cable examines Canadian perspectives toward NAFTA, including what Canada might seek if a future U.S. Administration sought to re-open or abrogate NAFTA.

¶2. (U) Canada is a G7 economy and a major trading nation. Its decisions to implement the Free Trade Agreement (FTA) with the United States in 1989 and to extend that agreement to Mexico in 1994 were important turning points in Canadian economic policy. The transition to free trade hurt some Canadian workers and industries, and public opinion was deeply divided over the FTA and NAFTA. While these divisions have been largely healed by subsequent economic prosperity, a small but vocal minority of Canadians continues to seek NAFTA's abrogation. (If NAFTA were abrogated, the U.S. and Canadian implementing laws would require a return to the 1989 bilateral FTA, which the same critics would also want to abrogate).

¶3. (SBU) While many Canadians believe that U.S. campaign trail references to abrogating or renegotiating NAFTA are unlikely to be followed through, U.S. criticism of NAFTA taps into Canadian anxieties about possible U.S. protectionism, alleged "thickening" of the border, and (in trade policy circles) lack of progress in the Doha Round. Reactions by Canadian policy leaders have emphasized the need to defend, preserve, and where possible, extend trade liberalization. Comments often cite Canada's status as the United States' largest supplier of energy and the world's second largest holder of oil reserves, albeit without explaining how this would play into a NAFTA abrogation/renegotiation. Some also mention (indeed they overplay) Canada's ability to choose to diversify its export markets toward China, Europe, and elsewhere.

¶4. (SBU) Where it exists, Canadian discontent with NAFTA (and earlier, the FTA) focuses on the continued use of trade remedy (anti-dumping and countervailing duty) laws, a related lack of effectiveness in dispute settlement reflected in over-use of the "extraordinary challenge" procedures (notably in pork, swine and lumber), and a clause (NAFTA Article 605) that prevents parties from

voluntarily restricting their exports of energy. Any return by the United States to the NAFTA negotiating table would likely see Canada present a well-prepared agenda aimed at making progress in these areas, which are well understood and discussed in Canadian trade policy circles. END SUMMARY/INTRODUCTION

CANADA'S POST-NAFTA PROSPERITY

¶5. (U) Canada has prospered since it concluded the FTA and NAFTA. Bilateral trade with the United States has more than doubled since NAFTA and more than tripled since the FTA. Subsidies and protectionist measures have dwindled and globally competitive sectors have grown. The Canadian energy sector has expanded due to higher prices, technical advances, and infrastructure investment in both natural gas and the oil sands. (Sixty percent of Canada's 2007 trade surplus with the United States consisted of U.S. net imports of energy). Government budgets are in surplus, inflation and Qof energy). Government budgets are in surplus, inflation and interest rates are low, and employment is very healthy. Strong commodity prices are driving growth in non-energy resource-based sectors (agriculture, mining) and are spurring exports to markets other than the United States. While trade liberalization was only one component of a set of policies and circumstances that led to this prosperity, it is difficult for NAFTA's critics to argue that the agreement has been bad for the economy.

REACTIONS TO U.S. ANTI-NAFTA RHETORIC

¶6. (U) In an environment of increasing anxiety in Canada about allegedly growing U.S. protectionism and "thickening" of the border, Canadian business, media, and political leaders have reacted to criticism of NAFTA in the U.S. presidential campaign -- notably to statements made in Ohio on February 26 by Senators Clinton and

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Obama.

¶7. (U) On February 27, the Canadian Council of Chief Executives (the leading big-business lobby) issued a statement claiming that "Protectionists in many cases are attacking the fundamentals of liberal economics. . . . In fact, it is now more important than ever for North Americans to work together in taking on the challenges of global competition. No Canadian needs to be reminded of the vital importance of the Canada-United States economic relationship. Trade and investment liberalization between our two countries has produced huge benefits on both sides of the border. But now this remarkable progress is endangered by a combination of forces pressing for higher security walls and economic barriers."

¶8. (U) Also on February 27, Finance Minister Jim Flaherty and International Trade Minister David Emerson separately made comments emphasizing the benefits of NAFTA to Canada, Mexico, and the United States. Going further, Emerson opined that current U.S. economic concerns stem less from NAFTA than from the housing and mortgage crises.

¶9. (U) The trade minister then reportedly stated that he is concerned with the growing stridency of protectionist forces in the U.S. Congress. As for abrogating NAFTA, Emerson was quoted saying that the short-term impact would be modest, except for the disappearance of NAFTA's dispute resolution features. "It's not so much more fights as a less neutral, well-defined way of resolving them," he said. "The dispute resolution mechanism, Chapter 19, has been generally speaking a real benefit for Canadian industry with the possible exception of softwood lumber."

¶10. (U) Emerson also commented that "There's no doubt if NAFTA were to be reopened we would want to have our list of priorities.... Knowledgeable observers would have to take note of the fact that we are the largest supplier of energy to the U.S. and NAFTA has been the foundation for integrating the North American energy market. When people get below the rhetoric and pick away at the details, they are going to find it's not such a slam dunk proposition."

ENERGY, AND EXPORT DIVERSIFICATION, OVER-PLAYED

¶11. (U) The Canadian media highlighted Emerson's allusion to energy

trade. The next day's top headline in a national newspaper read "Ottawa plays oil card in NAFTA spat," and subsequent commentators have picked up that theme. An early March poll said that 61 percent of respondents would favor using oil as a lever in future negotiations with the United States. A few commentators went further and suggested that Canada might choose to divert its energy exports to China or other third markets, if NAFTA were abrogated.

¶12. (U) Diverting significant amounts of Canadian oil and gas to overseas markets, however, would likely be a nonstarter. Canada's oil and gas exports rely on large, complex transcontinental pipeline networks. Exporting oil and gas overseas by tanker would be much less economic and (in the short run) physically impossible, as little of the infrastructure needed for such shipments currently exists.

¶13. (SBU) Talk of diversifying export markets away from the United States is constant in Canadian trade policy discourse. Since the 1960s, Canadian officials have regularly vowed to implement trade Q1960s, Canadian officials have regularly vowed to implement trade diversification policies, and have spent heavily on trade promotion in third markets, with little apparent result. The proportion of Canada's merchandise exports sold to the United States climbed steadily from about two-thirds in the late 1960s to nearly 86 percent in 2003. (It receded to 79 percent in 2007, but this likely resulted less from policy than from changing commodity prices and currency values, as well as growth in overseas markets).

OPPOSITION HAS WANED

¶14. (SBU) A nationwide coalition of forces opposed Canada's negotiation of free trade with the United States in the late 1980s and of NAFTA in the early 1990s. This alliance was concentrated mainly in the manufacturing sector of Ontario (the most populous province), in public service unions, in the union-based New Democratic Party (NDP), and in the left-nationalist wing of the Liberal Party. All of these constituencies have declined in political influence since that time. The current generation of the anti-trade lobby expresses itself in two main forms: an anti-globalization and anti-corporate movement that claims "solidarity" with groups in developing countries; and a relatively small number of lobbies for specific domestic industrial interests (e.g., Canadian Auto Workers, dairy farmers, shipyards).

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¶15. (SBU) The ideology expressed by Canada's hard core of anti-free-trade campaigners contains a strain of 1970s-era natural resource nationalism. This is reflected in their persistent claims, which have little evidentiary basis, that the FTA and NAFTA "sold out" Canadians' national patrimony of energy and water resources to allegedly insatiable U.S. consumers. Anti-free-trade campaigners ignore the fact that virtually no commercial interest has been shown in exporting bulk water, and that water in its natural form is not covered by either agreement (which the three NAFTA countries clarified in a December 1993 statement).

¶16. (SBU) As for energy, NAFTA's Canadian critics have always attacked Article 605, which prohibits a party from restricting exports of an energy or basic petrochemical good below the level (as a proportion of total supply) prevailing in the most recent three-year period. While this article has no practical effect as long as Canadians are willing to pay world market prices for these goods, it would prevent a future Canadian government from (1) responding to a supply disruption by reducing exports or (2) maintaining a lower domestic price at the expense of domestic producers. Critics cite Article 605 as proof that Canada "surrendered control of its energy policy" by signing NAFTA.

FREE TRADE NOT FREE ENOUGH

¶17. (U) Beyond these relatively narrow groups, Canadian public attitudes toward open markets and trade liberalization are broadly positive, and the constituencies for liberalizing trade are likely as strong or stronger than they were twenty years ago. Canadian poll respondents' support for NAFTA climbed steadily from about 30 percent in 1992 to about 70 percent by 1998, and remained near that level until at least 2002. A poll released on March 7, 2008, after years of deep job losses in manufacturing, found that nearly half of

respondents still thought NAFTA had been "good" or "very good" for Canada's economy, compared to 27 percent who thought NAFTA's impact had been negative. Ontario Premier Dalton McGuinty, whose manufacturing-intensive province has been hurt the most by those job losses, nevertheless argued in a March 13 op-ed piece that "NAFTA has helped preserve competitiveness by pooling [Ontario's and neighboring U.S. States'] shared strengths and resources" across an "integrated Great Lakes economy."

¶18. (SBU) After fourteen years of NAFTA and the five preceding years of the bilateral FTA, the overall balance of Canadian opinion on these agreements is not that they "gave too much away" in terms of access to Canada's market. Rather, the mainstream view is that the agreements did not fully deliver on the FTA's leading promise: access to the United States market that would withstand protectionist politics.

¶19. (SBU) The "poster child" for this view has always been the long-running softwood lumber dispute, which affects a sector of major economic and political importance in Canada. In that dispute, the Canadian side believes that it "won" repeated dispute settlement panel decisions, but nevertheless "lost" to endless procedural protectionism, because trade remedy procedures were never eliminated or restricted among the FTA and NAFTA partners. The elimination of such remedies within the free trade area had been urged by Qsuch remedies within the free trade area had been urged by economists, demanded by Canada, and alluded to in FTA Article 1906 (which anticipated "the development of a substitute system of rules" within five years). (Comment: Softwood lumber aside, Canadian access to the U.S. market is virtually total, while Canada retains a range of restrictions on U.S. goods and investment, e.g. in "cultural industries." End comment)

¶20. (SBU) Another area where Canadians express discontent with free trade is the perception that the United States is "thickening" its side of the U.S.-Canada border. Canadians use the "thickening of the border" phrase to describe allegedly increasing complexity of procedures, longer waiting times, and higher compliance costs for moving goods - and people - into the United States. The evidence for "thickening" is mostly anecdotal, and there is no convincing sign that it has reduced bilateral trade. Even if "thickening" does exist, it cannot be blamed on NAFTA and its effects are likely far smaller than those of other phenomena, such as exchange rate variability. Nevertheless, the widespread perception (and frequent assertions by Canadian Ministers) that "thickening" is occurring constitutes an additional area of Canadian dissatisfaction with free trade.

THE CANADIAN AGENDA

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¶21. (SBU) Whatever the U.S. campaign rhetoric might be, knowledgeable Canadian observers discount the possibility that a future U.S. Administration would abrogate NAFTA or seek to renegotiate substantial portions of it. Still, trade policy in general is more important to Canada than to many other major economies due to its relative openness and the prominence of trade as an engine of economic growth. Canadian policymakers are sensitive to perceived negative trends in the United States that impact trade (protectionist sentiment in Congress, complexity or "thickening" at the border, and the alleged ascendance of security over other concerns since 9/11).

¶22. (SBU) As a result, Canadian trade policy circles have moved quickly into relatively advanced discussion of key issues around a possible NAFTA renegotiation. The following are a few major points that have already been made publicly:

-- The Canadian and U.S. laws that implemented NAFTA at the end of 1993 did not terminate the bilateral FTA, but only suspended it (see U.S. Public Law 103-182, Section 107). If NAFTA were abrogated for any reason, the two countries would automatically revert to the FTA.

This provides a "fallback" arrangement for Canada if NAFTA's abrogation were driven wholly or primarily by U.S.-Mexico issues. Since the FTA was essentially the template for NAFTA, and both agreements provided for nearly complete elimination of tariffs between the two parties, if this occurred Canada's market access to the United States would be relatively little changed.

-- While the political climate in the United States might be less favorable to a bilateral trade negotiation in coming years than

during the Reagan Administration when the FTA was concluded, Canada is in a far stronger economic position, with good terms of trade thanks to high energy and commodity prices. Moreover, Canada is now the United States' largest supplier of imported energy, and holds the world's second largest oil reserves after Saudi Arabia.

-- In light of these circumstances, Canada (many commentators say) should be accelerating its push for bilateral and regional trade agreements in Europe, Asia, and elsewhere. (Canada has negotiated FTAs with the European Free Trade Area, Chile, Costa Rica, and Israel. It has FTAs pending with Korea, Singapore, the Dominican Republic and a number of countries in Central and South America, and recently announced the launch of free trade negotiations with Jordan). One former Liberal Minister of International Trade last week stated that Canada should accelerate efforts to reach an FTA with the European Union in order to counterbalance a possible weakening of trade ties with the United States if NAFTA were renegotiated or scrapped.

-- No significant part of the NAFTA can be renegotiated without reopening the agreement in its entirety. In that event, Canada would have a negotiating agenda of its own. Key features of the Canadian agenda would be to seek new rules constraining the use of countervail and anti-dumping laws between/among the parties; to strengthen dispute settlement mechanisms in ways that would enforce more lasting U.S. compliance; to possibly eliminate the investor-state dispute mechanism (NAFTA Chapter 11); and to possibly eliminate the article constraining export restrictions on energy products.

123. (SBU) Indeed, Canada could pursue major improvements to the bilateral trade regime, even if NAFTA remains in place. One eminent Canadian trade policy expert and veteran negotiator has proposed that Canada do just that. He is currently advocating that Canada spend the remainder of 2008 developing a "constructive agenda" to be pitched to the next U.S. Administration. That proposed "constructive agenda" would feature a major effort to address the security and regulatory dimensions of the bilateral trade relationship.

WILKINS